No. 10,078.

IN THE

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

HELEN M. SUTHERLAND, CHARLES W. SUTHERLAND, M. I. HIGGINS, MAYBELLE HIGGINS and HELEN MAUDE LORENZ,

Appellants,

vs.

FRANK A. GARBUTT, CHANDIS SECURITIES COMPANY, a corporation; ALICE CLARK RYAN, LOG CABIN MINES COMPANY, a corporation, and MUTUAL GOLD CORPORATION, a corporation,

Appellees.

APPELLANTS' REPLY BRIEF.

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Comments on Appellees' Statement of the Case.

"Appellees" will be used herein to designate Garbutt, Alice Clark Ryan, Log Cabin and Mutual Gold. Chandis Securities Company has also filed a brief which will be hereinafter separately answered.

Appellees, outside of matters already covered in Appellants' Opening Brief, have included many immaterial facts which tend to emphasize, first, the controversy between Vance and Garbutt and, second, a comparison of the two regimes. Vance's management is detailed and contrasted

with Garbutt's, and appellees recount at length, with implications of complete approval, Garbutt's activities in committing the acts complained of. It is entirely immaterial to the question of *ultra vires,* adequacy of consideration, constitutional rights arising out of stockholder relationship, business compulsion, and the like, whether Vance was a lumberman or a musician, whether he was a good manager or a bad manager, or whether he bought a second-hand mill or a brand-new mill. It is equally beside the point whether Garbutt had been in the mining business all his life or only since September 2, 1938, whether the mill that he installed cost $100.00 or $100,000.00, and whether he doubled the money for himself and the minority stockholders of his creature corporation and thereby put some money in the pocket of the stockholders of Mutual Gold, or whether he contributed large sums of money besides plowing back into the mine the proceeds of the ore he took out and thereby merely broke even. Likewise, whether or not Vance caused the instant suit to be brought (upon which there was no finding) is immaterial. In the last paragraph of page 15 of appellees brief Garbutt's achievements are summed up to the effect that he has done more than even the optional portions of the agreements contemplated and has made nothing from his deal. Appellants see no other effect in this recital than a comment upon his judgment as a mining man in engaging in the transaction and carrying it on to the extent indicated in the face of *optional* provisions which permitted him to retire at any time. In any event, and as argued

in Appellants' Opening Brief, and treated further hereinafter, the measuring stick of constitutionality and other requirements must be applied at the time the original transaction was entered into and not subsequently.

Appellees' statement of the case seeks, also erroneously, to paint an unrelieved picture of the condition of Mutual Gold, no doubt for the purpose of heightening Garbutt's role as an alleged savior. On page 3 of the brief they state that Mutual Gold was practically without funds to pay its obligations, and on page 4 that the whole enterprise appeared to have bogged down. The reference to support these statements is principally Tr. 406. There it appears merely that "Its creditors were not pressing" and, although the company did not have funds to carry on, "the mine was not in pressing need of money to pay its bills, but it was in need of money if it was to build a new mill or to operate its old mill." As appellants emphasize, Mutual Gold had two sources of financing. Even if it had only one, the Constitution and the law cannot be flouted.

On page 8 of appellees' brief, with reference to Tr. 466, 469 and 715, the statement is made that Garbutt arranged to obtain $25,000.00 to pay Vance and others, but that Vance refused to accept the money. This is repeated on page 20. On page 9, and also on page 10, reference is made to two different resolutions of the board of directors of Mutual Gold authorizing the borrowing of $25,000.00. On page 9 it is stated that this was to pay open account creditors "of which Vance was the largest," and on page 10 that it was to pay the "open

account creditors." The respective references are to Tr. 287 and 304. It appeared that Vance voted against both of these resolutions. The transcript does not show the purpose to which the corporation was planning to put the money, or why Vance may have refused the benefit of the loan Garbutt was arranging, but the impression is erroneously left that Vance repeatedly refused to accept payment on his claim or to permit the other creditors to be paid. We submit that this matter is immaterial, but, in any event, the treatement thereof is prejudicially erroneous. The material refusal was Garbutt's. As stated at page 57 of Appellants' Opening Brief, while acting in the double role of owner's agent and personal negotiator, Garbutt stated that if the full balance on the purchase price of the mine were paid he would not take it.

On page 12 of appellees' brief the statement is made that three of Mutual Gold directors on November 2, 1938, were elected to Log Cabin's board, giving Mutual Gold control of Log Cabin and that, subsequently, Mutual Gold was represented by either two or three directors, except for one period. The argument is that Mutual Gold therefore was fully advised and consented to all acts complained of. On page 26 of the brief appellants say that this representation is testimony to Garbutt's good faith and fair dealing. These directors, however, were Collins, Grill and Ferbert, who at all times while on the board of Mutual Gold and elsewhere, voted in favor of and worked for the transactions complained of. They, in short, always stood with Garbutt and their action in helping to consum-

mate an illegal transaction cannot deprive Mutual Gold of its rights. This is a derivative action brought by minority stockholders because Mutual Gold is in control of these men in collaboration with Garbutt.

The reference to the Vance suits in Spokane County, Washington, on page 13, including *Vance v. Mutual Gold Corporation,* referred to on page 15 of appellees' brief, is erroneous in that the court did not hold "much as the trial court did in the instant case." As stated in Appellants' Opening Brief, at page 70, the holding of the court, sustained upon appeal, was that the action be dismissed without prejudice. This case is in no sense *res judicata,* even though some of the findings of the factual history necessarily may have been similar to findings below in the case at bar.

As stated on page 14 of appellee's brief, all the stock of Mutual Gold was placed in escrow by order of the California Commissioner of Corporations. Although this was a developed mine which had produced large amounts of ore and had other ore blocked out, the stock was probably considered by the Commissioner the same as promotion stock, or stock of speculative value. Due to the fact that it was optional with Garbutt whether he invested more than the $10,000.00 the stock of Log Cabin was unusually speculative.

See:

Ballantine & Sterling (1938 ed.), California Corporation Laws, p. 360.

ARGUMENT.

Reply to Appellees' Comment on the Question of Ultra Vires.

It is immaterial whether the transaction is called a sale or an exchange. On page 16 the attempt is made to distinguish these terms. They, however, are essentially alike, as appears from the following authorities.

The distinction between a sale and an exchange of property is rather one of shadow than of substance. It can make no essential difference that goods and merchandise are transferred and paid for by other goods and merchandise instead of by money, which is but the representative of value or property.

Com. v. Clark, 14 Gray (Mass.) 372.

An exchange of property is a mutual transfer of one or more pieces of property for property other than money.

See:

23 *Corpus Juris (Exchange of Property),* Sec. 1, p. 184.

There is no substantial difference between sale and exchange.

See:

23 *Corpus Juris (supra),* Sec. 1, p. 186, and note 29, cases cited;

Gilbert v. Sleeper, 71 Cal. 290, 292, 12 Pac. 172, 173.

An exchange is two sales.

Robbins v. Pacific Eastern Corp., 8 Cal. (2d) 241, 269, 65 Pac. (2d) 42, 56.

In an exchange neither or both things received are money only.

> *U. S. v. Pan-American Pet. Co.* (1925, D. C. S. D. Cal.), 6 Fed. (2d) 43 at 83; aff. 273 U. S. 456, 71 L. Ed. 734.

However, whether it be a sale or an exchange, in view of the optional nature of the contracts, it is immaterial so far as the legality of the contracts are concerned that Garbutt paid $23,500.00 to the owners and something more than $100,000.00 in equipping and developing the property. Had he put in nothing beyond the $10,000.00, or had he put in a million dollars, the legal result would be the same.

Logie v. Mother Lode Copper Mines, 106 Wash. 208, 179 Pac. 835, upon which appellees rely to sustain the judgment, and which they state approved a transaction substantially like the one in the case at bar, is clearly no authority whatsoever for appellees, as we have pointed out in our Opening Brief, at pages 38 to 41. This case has been overruled, or, if not overruled, so emasculated that it is inapplicable to the case at bar. In fact the Supreme Court of Washington in the *Moore* case (Appellants' Opening Brief, pp. 38, 39) expressly pointed out the fact that the court in the *Logie* case did not consider the question of the adequacy of the consideration or any constitutional question, which matters are involved in the case at bar. The difference between inadequacy of the consideration in the case at bar and the adequacy of the consideration in the *Logie* case is set forth at pages 39 to 41 of our Opening Brief. Consequently, there is no such basis for the sustaining of the trial court's judgment. Appellees appear to concede, on

page 17 of their brief, that the unconstitutional nature of the transaction would follow hand-in-hand with the inadequacy of the consideration.

In the middle of page 17 of appellees' brief is a casual treatment of appellants' argument at pages 24-31 of appellants' brief. The failure to meet the contention that Washington follows the minority view, to the effect that a new law cannot change or burden intra-corporate relationship, including minority stockholder rights relating to sale of assets, and their failure to cite any authority to the contrary leaves this fundamental argument made by appellants determinative of the whole case.

In commenting on appellants' subhead (c), page 24 of appellants' brief, appellees take the position that Section 3803-61, *Rem. Rev. Stat.,* did not require Mutual Gold to amend its articles so as to include the provisions of the Act of 1933. The first few words of the section negative this argument completely by saying "except where otherwise *expressly* stated herein." (Emphasis ours.) Section 3803-37, *Rem. Rev. Stat.*, as pointed out in Appellants' Opening Brief, at page 32, states that a corporation may amend its articles so as to "*include* any provision authorized by this act." (Emphasis ours.) An inclusion is not the elimination of a difference under the examples given by the appellees on page 18 of their brief, such as conflict in the matter of a quorum. "Include" does not mean the same as "conform." In order for this new provision of the Act to become a part of the articles of incorporation it must be included by an amendment.

Even if appellees' argument is sound, nevertheless it would be necessary for the stockholders of the corporation to adopt an amendment. The common law as it existed in the State of Washington at the time the corporation

was organized is a part of said articles of incorporation, as it is of all contracts. The common law required unanimous consent of the stockholders to approve sale of all the assets and for a change to be made by a subsequent statute lowering the percentage of stockholders who must consent, an amendment to the articles must be adopted, the same as in the example given by appellees.

Appellees endeavor to state, on page 18 of appellees' brief, that our contention concerning the necessity of amending the articles is not well taken, for the reason that otherwise no liability under Sections 3803-20-2, 3803-25, 3823, and Sections 2639, 2641, 2642, 3828 and 3829 could arise. However, these latter sections lend no support to appellees' argument, because they have nothing to do with any existing contract. A director or officer has no vested right in paying dividends out of capital or in defrauding creditors, and no contract right of a director or officer has been impaired. As for liability of a shareholder for the unpaid amount of his stock subscription, that is merely a codification of the common law rule.

It is true, as appellees state on page 19, that the articles provide that the corporation may acquire by purchase mining rights and may sell, exchange, lease or in any other manner dispose of the same. *This, of course, means in a lawful and proper manner,* and one of the limitations upon the exercise of such a power is that such exercise cannot make a fundamental change in the charter so as to divert the corporation from its original objects and purposes. The diversion consists in the loss of title to all assets, plus loss of all control over such assets and the management thereof, for an entirely inadequate consideration. All the corporation had left of a positive nature was the contingency of receiving dividends.

In response to appellees' statement, on page 21, which attempts to meet subdivision (f) dealing with the impairment of obligation of contract and due process, it is sufficient to say that the matter of cumulative voting is purely a procedural one and, so far as voluntary dissolution of corporations or cumulative voting, for that matter, the problem is whether vested rights are involved and the desirability of such statutory provisions is immaterial. Appellee cites no authorities in support of his unsound argument.

Appellees' reply to subhead (g) on page 46 of appellants' brief (page 22 of appellees' brief) to the effect that the transaction in question left Mutual Gold with the same powers that it had previously, except that it doesn't have the power to operate the mine, is unsound. In the first place, Log Cabin, the new corporation, owns substantially all of the assets, and Mutual Gold, as a stockholder, has no ownership in the corporate property as such, but only the right to receive dividends, if any, and to receive any portion of the property on liquidation, if any such exist. Mutual Gold, by virtue of its being a minority stockholder, has nothing to say in connection with the management of the property, or the control of the corporation, which is vested in Garbutt, the majority stockholder. Mutual Gold, instead of being the operating company, is relegated to a passive position. A more perfect example of a corporate shell could hardly exist.

The sufficiency and adequacy of the consideration of a contract must be determined from the facts of the transaction as they existed when the contract was entered into, rather than by subsequent developments, whether good or bad. Equity will not estimate the fairness and adequacy

of the purchase price with relation to events occurring subsequently to the time when the parties contracted.

Long Beach Drug Co. v. United Drug Co. (1939), 13 Cal. (2d) 158 at 165, 88 Pac. (2d) 698 at 701;

Gosnell v. Lloyd (1932), 215 Cal. 244 at 254-5, 10 Pac. (2d) 45 at 49;

Parsons v. Cashman (1913), 23 Cal. App. 298 at 301, 137 Pac. 1109 at 1110;

Morrill v. Everson (1888), 77 Cal. 114 at 116, 19 Pac. 190.

See:

6 *California Jurisprudence (Contracts),* Sec. 116, p. 167, and Sec. 128, p. 190.

In the *Morrill* case, *supra,* an option similar to the one in the case at bar was involved, in connection with the purported consideration.

Illegality.

This is treated on pages 50-52 of Appellants' Opening Brief. Appellees' reply is on pages 23 and 24 of their brief. Appellees are in error in stating that it is immaterial that no mention was made in the notice of the stockholders' annual meeting that ratification of the December contract would be considered. The contention is that at such a meeting any ordinary corporation matter could be brought up for action. In the first place, ratification of the December contract was not an "ordinary" matter, because it involved the sale of substantially all of the assets of Mutual Gold and made that company merely a corporate shell. It is well known that stockholders usually

pay little attention to notices of meetings. If the stockholder is informed of a matter which will come up which will vitally affect his interests he can then arrange to be present in person or can name and instruct a proxy how to vote on the matter. The stockholder is lulled into a false sense of security where the notice fails to mention the vital matter to be considered.

As we said on page 51 of Appellants' Opening Brief, the Washington statute provides for the purpose of stockholders' meetings to be stated in the notice.

The notice of a general or annual meeting must specify the business to be considered which is extraordinary or unusual and not ordinarily brought up at a general meeting, such as the sale of substantially all of the corporation's property, the increase of its stock, amending its by-laws in an important particular, increasing the number of directors, and the like. (See Appellant's Opening Brief, pages 50-52.)

See:

18 *Corpus Juris Secundum (Corporations),* Sec. 544(3), p. 1230;

5 *Fletcher Cyc. Corp.* (Perm. ed.), Sec. 2009, pp. 47-49; Sec. 2016, p. 79;

Des Moines Life & Annuity Co. v. Midland Ins. Co. (1925, D. C. D. Minn.), 6 Fed. (2d) 228 at 229 (sale of all of corporation's property);

Starrett Corp. et al. v. 5th Ave. & 29th St. Corp. (1932, D. C. S. D., N. Y.), 1 Fed. Supp. 868 at 871 and 874 (sale of all of corporation's property);

Johnson v. Tribune Herald Co. (1923, Ga.), 116 S. E. 810 at 812;

Dolbear v. Wilkinson, 172 Cal. 366 at 369, 156 Pac. 488 at 490.

Further, appellees say that the notice stated the meeting was for the purpose of electing a board of directors and for the transacting of "any other business that may *properly* come before said meeting." (Emphasis ours.) Appellants contend that such matter as a ratification of the December contract could not "properly" come before a meeting unless specific notice were given of the same in the notice. The purpose of a notice is to inform stockholders what is to come before the meeting and to give them the opportunity to attend if an important matter is to be considered. Therefore the said notice is not a legal notice, because it is not sufficient to apprise the stockholders of the unusual, extraordinary or important matter which the meeting may attempt to consider. The "other business" provision in the Mutual Gold notice of the stockholders' annual meetings of February 1, 1939, and August 6, 1938, was therefore legally insufficient [Tr. 606, 239-240].

See:

5 *Fletcher Cyc. Corp.* (Perm. ed.), Sec. 2009, p. 50;

Dolbear v. Wilkinson, supra, 172 Cal. 366 at 370, 146 Pac. 488 at 490;

Bushway Ice Cream Co. v. Bean Co. (1933, Mass.), 187 N. E. 537 at 539;

Bagley v. Reno Oil Co. (1902, Penn.), 50 Atl. 760 at 762.

Business Compulsion.

This is treated by appellants on pages 53 to 65, inclusive, of the Opening Brief. Appellees reply with a few lines on page 24. Appellants do not concede that the matter is disposed of by Findings XXXIX and XL [Tr. 201, 202] for the following reasons: The transcript references of the appellees relate to various details of the inception of the September 2d contract, the attempt to get De Mille interested, the financial status of Mutual Gold, the expressed preference of the majority of the directors to deal with Garbutt rather than Vance, the statements of Garbutt that he was reluctant to enter the deal, Garbutt's qualifications as a mining man and the statement of certain of the Garbutt directors of Mutual Gold that what Garbutt said did nothing to coerce them and that they were not frightened by notices of forfeiture. We see nothing sufficient in this line of testimony to support the findings, even if they are applicable to business compulsion, nor does this evidence constitute any substantial conflict with the evidence referred to on pages 53 to 62 of Appellants' Opening Brief establishing business compulsion and to which the Court's attention is again respectfully directed.

Trusteeship.

Appellees' comment on appellants' trustee argument consists mainly of a repetition of the recital of what Garbutt did after he had consummated the illegal and unconstitutional transactions appellants complain of. Such is entirely immaterial and particularly is it immaterial that on the witness stand he offered to enter into negotiations designed to pay him back half his advances in cash and the rest over a reasonable time.

Reply to Brief of Appellee Chandis Securities Company.

The argument of this appellee consists of the single point that appellants cannot demand recognition of Mutual Gold as the purchaser of the mining claims under the allegations of the complaint inasmuch as the appellants make only a general offer to do equity and do not offer to pay the owners the balance of the purchase price. The allegations of the complaint are as follows:

> "Wherefore plaintiffs, as such stockholders of Mutual Gold Corporation, and in its behalf, hereby offer to pay the amount of said installment (November 1, 1939) to keep the purchase contract in good standing as the property of Mutual Gold Corporation, and, upon such payment, be subrogated to all the rights of the owners in respect to said installment." [Tr. 16.]

> ". . . plaintiffs further allege they are willing, and hereby offer to do equity in the premises as same may be adjudged, declared and determined by this court, and they are likewise willing, and hereby offer, to abide by and perform any and all requirements and conditions that may be imposed by the court as attendant on, and precedent to the granting of the relief prayed, or to which the court may conclude the plaintiffs and other stockholders and creditors are entitled." [Tr. 20.]

The Court will note that the complaint was filed December 20, 1939 [Tr. 98], almost two years before the final payment of $100,000.00 became due.

Inasmuch as this is a derivative suit, in any event, it would not be proper to visit upon stockholder plaintiffs as strict requirements of pleading as if Mutual Gold, the real party in interest, were the plaintiff.

Be this as it may, this is a court of equity. It can provide in its decree for the method by which Mutual Gold shall meet its obligations to appellee Chandis Securities Company and such other matters as the Court deems necessary to do equity among all the parties.

See:

10 *California Jurisprudence (Equity),* Secs. 50 and 51, pp. 508-11, 512;

Rosemead Co. v. Shipley Co. (1929), 207 Cal. 414 at 421, 278 Pac. 1038 at 1042;

Seeger v. Odell (1941), 18 Cal. (2d) 409, 417-418, 115 Pac. (2d) 977, 982;

Lawrence v. Ducommun (1936), 14 Cal. App. (2d) 396 at 399, 58 Pac. (2d) 407, 408.

In *Michaels v. Pacific Soft Water Laundry,* 104 Cal. App. 349, 360 to 361, 286 Pac. 165 at 170, which was cited by appellee Chandis in support of its argument, the California District Court of Appeal stated that a failure to make any offer to restore is not fatal to plaintiff's cause of action, because the suit being in equity, "the court may do exact justice between the parties and is not limited to the offers and demands of the pleadings;" the court further stated that the court's "decree can fully adjust the equities between the parties."

Appellants therefore submit that the judgment should be reversed and relief granted as prayed in the complaint.

Respectfully submitted,

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